Gimme Shelter

Top 10 tax breaks, on the house

By Broderick Perkins

The New Year always turns thoughts to the new tax season and when it comes to taxes there's no place like home to find shelter.

Your home offers a score of tax deductions and credits designed to help offset the cost of housing and to keep the housing market fueled with new buyers.

Some federal-level politicians would like to separate you from some of those benefits and they may or may not be successful, so take advantage of them while you can.

Here's a look at the Top 10 Tax Breaks, On The House. Visit the **Internal Revenue Service's website** for more details on each item.

- **Mortgage Loan Interest:** The Mother Of All Tax Breaks, because interest payments comprises a large portion of your mortgage payment in the early years of the loan's term, mortgage interest on a maximum of $1 million in mortgage debt secured by a first and second home is deductible. Deductions reduce your taxable income against which your taxes due are calculated. The $1 million level applies to joint tax filers. You get half the deduction if you file single or separately.

  Likewise, home equity loan interest is deductible, but limited to the smaller of $100,000 (half as much for each member of a married couple if they file separately), or the total of your home's fair market value as determined by a complicated formula you may need a tax professional's help to decipher.

- **Home Improvement Loan Interest:** The interest on a home improvement loan is also deductible, but calculated differently. You can deduct all the interest on a home improvement loan provided the work is a "capital improvement" rather than repairs, maintenance or cosmetic upgrades. Capital improvements typically increase your home's value (say, because you added a room), prolong it's life (a new roof) or adapt it to new uses (universal design improvements to assist older people or people with disabilities). You get tax benefits from repair work (painting, repairing, etc.) only when you sell your home but you can use a home equity loan to make repairs and deduct the interest -- up to the limits.
- **Points:** Points, each equal to 1 percent of the loan principal, are charged by lenders as part of the cost of the loan. You can fully deduct points associated with a home purchase mortgage, but not a mortgage broker's commission. Refinanced mortgage points are deductible too, but only when they are amortized over the life of the loan. Once you refinance a second time, the balance of the old points from a refinanced loan offer an immediate write off, as you begin to amortize the new points.
- **Property Taxes:** Property taxes or real estate taxes are fully deductible. Any local city or state property tax refunds reduces your federal property tax deduction by the same amount.
- **Capital Gains Exclusion:** Home buying investors' best tax shelter comes from provisions in the Taxpayer Relief Act of 1997 which allows married taxpayers who file jointly to keep, tax free, up to $500,000 in profit on the sale of a home used as a principal residence for two of the prior five years. The amount is halved for those filing single or separately. You can use the benefit as often as you qualify.

- **Home-Based Business Deduction:** Home offices that use a portion of your home exclusively for business could qualify you to deduct a percentage of costs related to that portion. Included are a percentage of your insurance and repair costs, utility bills and depreciation. Under clarified provisions of the Taxpayer Relief Act of 1997, if your home office qualifies, you don't have to allocate a home sale's capital gains between the home and the business.

  Previously if you used, say, 10 percent of your home for a home-based business, 10 percent of the gain from a sale would be subject to capital gain taxes and you couldn't use the capital gains tax exclusion on that portion. The clarified provision does not excuse you from a recapture tax if you've taken a depreciation deduction because of the home-based business.

- **Selling Costs and Capital Improvements:** When you sell your home, you can reduce your taxable capital gain by the amount of your selling costs, which include real estate commissions, title insurance, legal fees, advertising and inspection fees. Cost typically stemming from decorating or repairs -- painting, wallpapering, planting flowers, maintenance, and the like -- are also selling costs if you complete them within 90 days of your sale and with the intention of making the home more saleable.

Selling costs are deducted from your gain. Gain is your home's selling price, minus deductible closing costs, minus selling costs, minus your tax basis in the property. Your basis is the original purchase price, plus the cost of capital improvements, minus any depreciation.

- **Moving Costs:** A move triggered by a new job comes with some deductible moving costs. To qualify, you must meet certain requirements including, moving within one year of starting your new job, moving 50 miles farther from your old home than your old job was and working full-time at the new job for 39 of 52 weeks following the move. Deductions include travel or transportation costs and expenses for lodging and storing your household goods.
- **Mortgage Tax Credit:** Mortgage Credit Certificates (MCCs) allow qualifying low-income, first-time home buyers to take a mortgage interest tax credit of up to 20 percent (the amount varies by jurisdiction) of the mortgage interest payments made on a home. This credit is available every year you keep the loan and live in the house purchased with the certificate. Unlike a deduction that reduces your income, the credit is subtracted, dollar for dollar, from the income tax owed. For example, with a 20 percent tax credit, if you paid $10,000 in interest, your tax credit would be $2,000. If you owe $2,000 in income taxes without the credit, you would end up owing nothing to the IRS after the credit was applied. The remaining 80 percent of your mortgage interest -- $8,000 -- is taken as a normal mortgage interest deduction.
- **Energy Tax Credits:** The newest home-based tax credits were made possible last year by the Energy Policy Act of 2005. Tax credits of up to $500 in 2006 and 2007 are available for upgrading heating and air conditioning systems, insulations, windows, doors and thermostats, caulking leaks, installing pigmented metal roofs and for otherwise putting the bite on energy waste in your home. Qualified solar energy and fuel cell systems can net tax credits of up to $2,000. Some states also offer tax credits or rebate deals that could reduce the federal credit. Related tax credits are available for consumers who buy alternative- and clean-fuel burning cars and for entrepreneurial consumers who install clean-fuel vehicle refueling property at the principal residence of the taxpayer.

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